Directorate of Intelligence

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US and Other Western Investment in Chinese Oil: How Much Interest Remains? [redacted]

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An Intelligence Assessment

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EA 86-10020
May 1986

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Directorate of Intelligence

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US and Other Western Investment in Chinese Oil: How Much Interest Remains? [redacted]

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An Intelligence Assessment

This paper was prepared by [redacted] Office of East Asian Analysis. Comments and queries are welcome and may be directed to the Chief, China Division, OEA, [redacted]

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US and Other Western Investment in Chinese Oil: How Much Interest Remains? [redacted]

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Scope Note

Domestic demand and foreign exchange needs in recent years have pushed the Chinese to increase oil production and exploration, and to seek greater participation by foreign companies. This paper evaluates China's latest strategies for attracting foreign cooperation in oil, and examines the threats to these strategies posed by the current falloff in international oil prices. [redacted]

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US and Other Western Investment in Chinese Oil: How Much Interest Remains?

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Key Judgments

Information available as of 21 April 1986 was used in this report.

The Chinese have been trying to attract increasing cooperation in oil exploration and development—onshore as well as offshore—because of their:

- Reliance on foreign exchange earnings from oil exports.
- Growing domestic demand.
- Disappointment over the results so far of offshore exploration.

We believe, however, that falling world oil prices are undercutting Chinese hopes of attracting the cooperation they need, at least over the near term. China, in fact, probably will be forced to grant more favorable terms for new contracts just to sustain the interest of the few large Western firms—mostly American—that are still financially able and willing to take the necessary risks. 25X1

A falloff in Western interest onshore will, we believe, force Beijing to reexamine its long-term plans for onshore oil development. Most at risk are Chinese plans for developing in the 1990s the massive oil basins in the remote northwest—considered by many world geologists to have extremely rich potential. If these plans are pushed back, Chinese efforts to sustain high oil production beyond 1990 would, we believe, hinge less on new oil finds and increasingly on the use of improved recovery techniques to maintain production in existing mature fields. 25X1

China's oil industry officials, meanwhile, probably will devise contingency plans to develop the northwestern basins with only limited foreign involvement in testing and planning. We believe the Chinese could undertake such an independent effort only at enormous cost and very slowly, delaying development of these resources by as much as a decade. 25X1

US oil firms will be affected more than other foreign companies because they are more deeply involved in China. They have provided expertise, equipment, and most of the direct foreign investment in the search for oil:

- US firms have taken the lead on most offshore oil surveys.
- Total US investment obligations for the first round of offshore oil cooperation ran $800 million, almost half of foreign commitments.
- Consortiums led by US firms have found four of China's seven offshore discoveries to date.
- US firms have sold China over $700 million in oilfield equipment.

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As a result of the drop in oil prices, only the large, mainly US, oil companies are likely in our judgment to maintain an interest in China. Indeed, most foreign firms so far have found the results of investing in China's offshore oil industry to be mixed at best, with few of them earning enough to cover their costs. Many Western firms have sustained losses in the tens of millions of dollars. And scant reliable data about onshore prospects—frustrating all attempts to predict oil potential—will, we believe, discourage all but the largest companies from investing in further exploration over the short to middle term. [redacted] 25X1

Among US specialty firms, those selling oil equipment face poor prospects within a year or two. We judge that China will be forced by budget cuts—despite its priorities—to reduce purchases of equipment for its existing onshore fields and will increase efforts to obtain manufacturing know-how to begin producing its own. In the meantime, we expect the Chinese to meet some of their immediate needs by buying used equipment from small US independents that are in financial difficulty. As the Chinese are forced to rely increasingly on their own resources, on the other hand, we think US oil exploration consultants will be in a strong position to sell their services to Beijing. [redacted] 25X1

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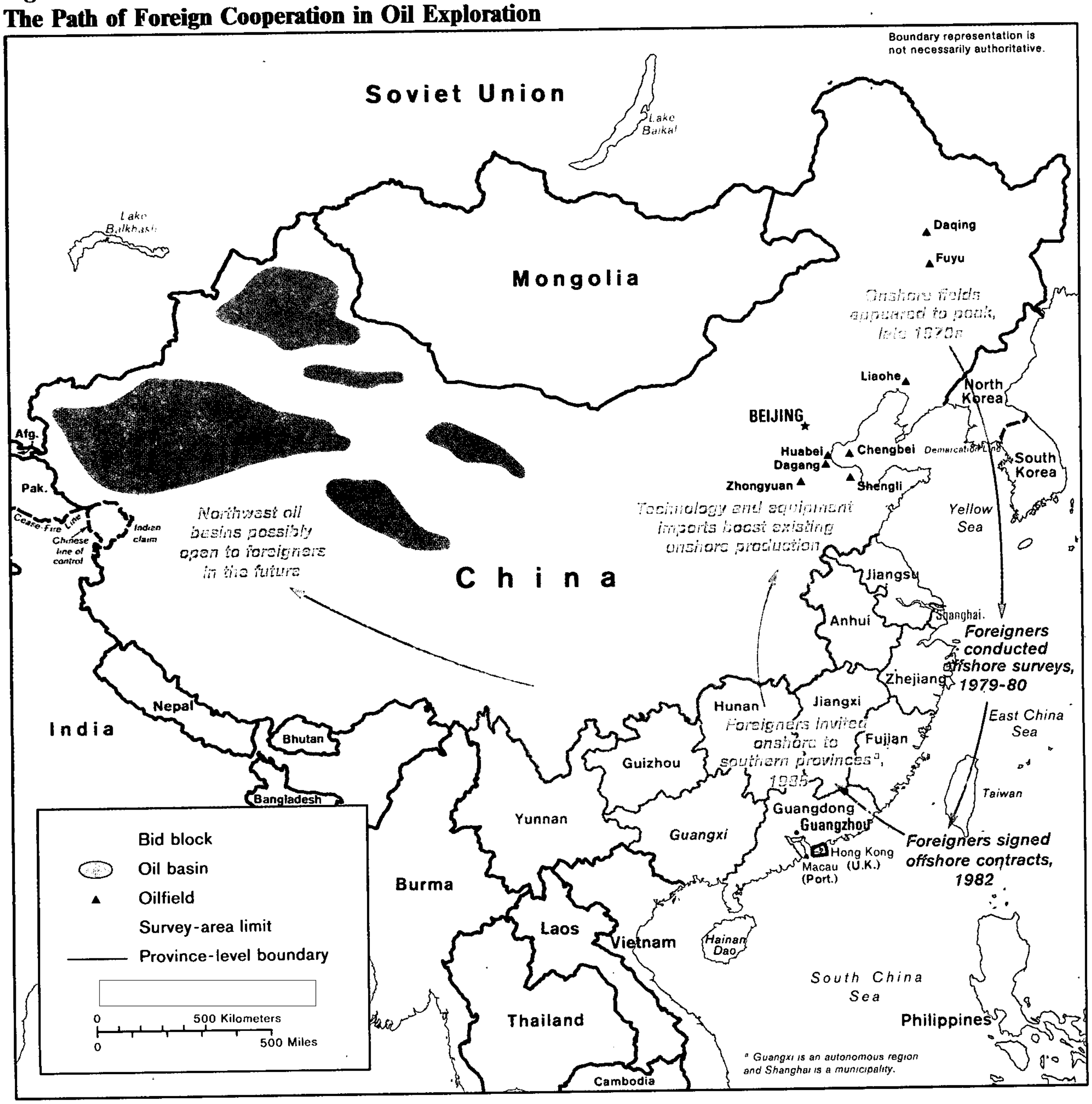
Figure 1
The Path of Foreign Cooperation in Oil Exploration



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US and Other Western Investment in Chinese Oil: How Much Interest Remains? [redacted] 25X1

China's Turn to the West

Foreign cooperation in China's oil exploration has expanded since the late 1970s as the Chinese petroleum industry has come under growing pressure to increase production for both export and consumption:

- Oil has been one of China's most important sources of foreign exchange, providing one-fifth of its export earnings. Faced with growing protectionism against such traditional exports as textiles, China has increasingly relied on oil to earn foreign exchange.

- Rapid expansion of the domestic economy has strained energy supplies beyond Beijing's expectations. Incentive policies have reduced waste, but new household and industrial consumers are taxing supplies and disrupting planning. Growth in the transport sector also has created increasing demand for fuels. [redacted]

With Western assistance, according to press reports, China had expected to find enough oil offshore to meet domestic and export needs and to more than compensate for the eventual decline in output from mature onshore fields. The Ministry of Petroleum Industry (MOPI) also had expected the earnings from the offshore fields to provide much of the funding to develop new onshore production in potentially rich areas of China's remote northwest. Instead, the results have been disappointing, and the prospects of making a major find are slim because the most promising areas have been explored. In contrast to China's expectations of 1-2 million barrels per day (b/d) by the 1990s, offshore production stands at roughly 20,000 b/d. We estimate that, without a major discovery, 1990 offshore production will reach 200,000 b/d at best. [redacted]

In 1985, China suffered an unprecedented trade deficit—nearly $15 billion, according to Chinese statistics—in spite of exporting almost all of its increase in oil production. At the same time, industrial growth of 18.4 percent exceeded all expectations and added to the strain on domestic energy supplies. [redacted] 25X1

Because of increasing demand but reduced expectations of finding oil offshore, China in 1984-85 revamped its plans for developing the industry through the rest of the decade. [redacted] 25X1
China decided to expand exploration efforts with foreign participation, looking for small, independent firms in particular to increase competition. In 1984-85, several years ahead of schedule, MOPI offered for bid a second round of offshore oil blocks and invited Western participation in developing onshore basins in 10 southern provinces. [redacted] 25X1

But late last year Beijing's plans began to unravel. 25X1
Plummeting world oil prices beginning late in the year undermined China's plans to increase revenues through exports, and, [redacted] 25X1
have forced Western firms to reconsider oil exploration programs. According to [redacted] 25X1
trade journals, many firms have cut exploration budgets drastically, and the smaller firms China had hoped to attract will be struggling just to stay in business. [redacted] 25X1

Poor Results in the First Round Offshore

China first opened offshore areas to foreigners in October 1978, inviting oil companies to conduct surveys in exchange for the right to bid for concessions. The unexplored basins off China's coasts were the largest in the world, and foreigners and Chinese alike believed that recoverable reserves could run into hundreds of billions of barrels, making China a new Saudi Arabia. Earlier, unsuccessful Chinese efforts to find and produce oil offshore convinced MOPI that foreign help would save time and money and increase production. [redacted] 25X1 25X1

Summary of Proceedings in the First Offshore Round

Firms from 17 countries carried out the surveys in 1979-80 at a cost of $200-300 million, according to press estimates, with US firms taking the lead in six of nine survey areas. MOPI developed a model contract for foreign cooperation based on Indonesian and Norwegian regulations. Following the surveys, China in 1980-82 negotiated several production-sharing contracts bilaterally with French, Japanese, and US firms, and in February 1982 offered the other offshore blocks for award to the highest bidder. [redacted]

Through the China National Offshore Oil Corporation (CNOOC)—a subsidiary created in 1982 specifically to deal with foreigners in offshore oil cooperation—MOPI signed 19 contracts with 28 oil companies from nine countries, announced through 1983 and 1984; Amoco signed a final contract for the first round in November 1985. China elected to develop only one area in the Bohai by itself. [redacted]

Drilling began in late 1982 in negotiated areas and in late 1983 in blocks awarded by bid. By January 1986, the Chinese announced that over 110 exploratory wells had been drilled, with oil and/or gas shows in about 40. But only seven wells are capable of producing more than 7,000 barrels of crude per day, according to press reports; four belong to US-led consortiums. [redacted]

At least three consortiums completed the drilling they contracted for by the end of 1985, but several participants have committed themselves to further exploration in 1986. The blocks awarded and the discovery wells drilled are shown on the foldout maps. [redacted]

The quantity of oil discovered (see inset) has been extremely disappointing to both Chinese and Western participants. [redacted] MOPI has had to cajole several companies to complete their drilling, in some cases offering additional acreage adjacent to original bidding blocks. British Petroleum, which drilled 18 dry holes, was allowed to meet its commitments by drilling in shallows abandoned by French Total, where drilling costs were cheaper and the potential for oil no less. [redacted]

Status of Production at Offshore Wells

The Bohai. *Japanese discoveries in the Bohai provided China's only offshore oil production in 1985, with three well sites providing 1,460 b/d—a trickle compared with China's onshore production of 2.5 million b/d. Japan's luck with its wildcat wells (hitting oil in its first four wells) proved misleading for the amount of oil to be found in the Bohai. Still, expectations are high for the newly tapped Chengbei reservoir, also in Japan's Bohai block. Production began last September, and once all wells are operational—with some coming on line in 1986—the Chinese expect Chengbei to yield at least 8,000 b/d, of an expected total output of 20,000 b/d in the Bohai.* [redacted] *China hopes to make Chengbei its top priority offshore,* [redacted]

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The Beibu Gulf. *Beijing is pressing to produce as much as possible in the Beibu. CNOOC subsidiaries took over areas abandoned by foreigners, while CNOOC pressed the French firm Total to begin test production by July 1986. Press reports indicate that China's joint venture with Total has budgeted $160 million for the development of the Beibu field. Planned initial production for the second half of 1986 will average about 10,000 b/d, rising to 16,000 b/d in 1987 and eventually peaking at 24,000 b/d.* [redacted]

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The Chinese have pushed hard to develop whatever oil has been found. Japanese discoveries in the Bohai have been put into production, and French finds in the Beibu Gulf are scheduled to be in production by midyear (see inset). A joint venture also has been established with Arco to develop a huge natural gas find in the Yinggehai, but the Chinese say gas from this field will not be available before 1992. [redacted]

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First-Round Outlook: Few Winners

Before the recent fall in oil prices, participants expected to profit by selling in the international oil market their share of oil produced from their discoveries. Indeed, the French and Japanese firms active in the Bohai and Beibu may still profit. Esso, Philips, and Chevron-Texaco have also found deposits that may prove commercially profitable, although their status is still unclear. [redacted] other participants—including several US firms, British Petroleum, and joint Chinese-foreign firms that have found no commercial discoveries—have sustained losses totaling hundreds of millions of dollars. [redacted] 25X1

Having foreigners absorb all exploration costs has allowed China to avoid major financial losses offshore. We believe China has overinvested in shore-based support industries, however—spare parts, food, and transport services—which, given the disappointing finds offshore, have provided unexpectedly low revenues. [redacted] 25X1

The Second-Round Bidding

We believe the disappointing results offshore made the Chinese worry about how much oil they would get from offshore wells—and how much foreigners would bid for later blocks. After consulting with first-round participants, the China National Offshore Oil Corporation (CNOOC) accelerated the offshore program and in late 1984 offered a second set of blocks before the first round proved unsuccessful. To maintain foreign interest in bidding, the Chinese heavily publicized even minor oil findings in the first round, and downplayed reports of unproductive wells. Four contracts were signed in late 1985 (see table), and CNOOC President Qin Wencai said in December that he expected another six or seven to be signed in 1986, with drilling to begin this October. Through April, only three more contracts had been concluded, and no drilling plans have been announced. [redacted] 25X1

China's negotiating position has been considerably weakened for the second-round blocks, both by poor first-round showings and by declining world oil prices. At first glance, the second round appears to have drawn almost as much interest as the first (24 versus 28 participants), but the comparison is misleading. [redacted] 25X1

The Second Round Offshore: Signings

	Firms	Date	Area (sq km)	First-Round Participant
Japan	Japex Huanan Oil Nippon Mining	11/08/85	5,100	No
US	Esso Shell (UK)	11/15/85	3,876	Yes
US	Philips Pecten	12/17/85	4,473	Yes
US	ACT	12/21/85	NA [a]	Yes
UK	Cluff	02/05/86	NA [a]	Yes
US	Amoco	02/18/86	639	Yes
US	Occidental Unocal (US) Japex (Japan)	03/28/86	5,470	Yes

[a] Data not available.

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[redacted] 25X1

[redacted] 25X1 25X1 those first-round participants that also bid in the second round had been given an extra incentive to participate, which was well publicized by the Chinese: additional acreage was tacked onto their first-round blocks if they bid in the second round. [redacted] 25X1

According to industry journals, six of the seven contracts signed thus far are with companies that found oil in the first round, and are for the blocks nearest the better first-round discoveries made in the Pearl River Basin (see figures 3 and 4). The second-round blocks already signed were almost certainly viewed as the most promising and thus were most likely to draw a number of bids. If the remaining blocks have only one or two bidders, we expect the Chinese to face long negotiations on each block and a choice between far less desirable terms or no contract at all. It will be difficult to tell, however, what the Chinese offer or agree to on the new blocks; contract terms in the first round were kept secret. [redacted] 25X1

Opening the Southern Provinces

By utilizing foreign funds and implementing technological cooperation to exploit onshore oil resources, we shall quicken the pace of prospecting China's gas and oil, and improve the situation in central, south, and southwest China where there is an energy shortage, accumulate funds, and train our personnel, thus creating conditions for large-scale oil exploitation in northwest China in the future. [redacted]

—Chinese newspaper editorial

China's petroleum needs and the disappointing offshore results compelled the oil ministry to consider letting foreigners invest in onshore efforts. During an autumn 1984 visit to the United States, Minister of Petroleum Tang Ke broached the idea of direct foreign investment at existing eastern fields and one or two new basins in the south as a prelude to cooperation in the northwest. That winter, however, MOPI decided instead to open 10 provinces in southern China to foreign cooperation (see figure 2). The Chinese claim the 10 southern provinces have oil potential in 136 basins, nine of which are larger than 10,000 square kilometers. Geologists familiar with China think that several of the basins are large enough to hold a major field, such as Shengli, but none of them has been explored enough to make meaningful estimates. The Chinese to date have carried out only a limited number of surveys and drilled a relatively small number of wells that they claim produce about 14,000 b/d. [redacted]

What the Chinese Want . . .

We believe the Chinese want foreign investment in the southern basins to help them attain several goals:

- Experience in dealing with foreigners at more accessible onshore locations before jointly tackling the remote northwest.
- Oil concession earnings for MOPI, including foreign exchange.
- Acquiring at least some oil by the early 1990s for local consumption and possibly for export.
- Attracting new investors in the hope that the additional competition will strengthen MOPI's bargaining position in the south and later in the northwest.
- Further developing China's oil support services and access to foreign technology, equipment, and training. [redacted]

Developing the Northwest: Promising But Formidable

Three areas in the distant desert regions of northwestern China are considered by Chinese and Westerners alike to have extremely rich oil potential—the Tarim, the Jungar, and the Qaidam basins (see figure 1). These areas are huge—Tarim alone is 550,000 square kilometers—and their remoteness and inhospitable climate make exploration and assessment difficult. The Chinese conducted small-scale surveys with primitive equipment in the northwest in the 1950s and 1970s and are now producing oil for consumption within the region. The Karamay oilfield in the Jungar basin, for example, produces about 70,000 b/d, according to the Chinese press. [redacted] 25X1

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Oil geologists throughout the world agree that these basins hold considerable potential, but reserves estimates, being speculative, cover a wide range, with Beijing providing the most optimistic figures. The Chinese estimate that Tarim holds 10 billion tons of oil in place and compare Qaidam's reserves to Saudi Arabia's; Western geologists think Tarim has the most oil, but with actual recoverable reserves closer to 1-2 billion tons. [redacted] 25X1

China's main problem in developing these basins is their distance from developed areas. Beijing has told Western oil companies that it wants to develop a more detailed assessment of the region, and to calculate the costs of pipelines to move oil to consumers to the east. A US firm recently estimated that a pipeline from Tarim to Lanzhou—2,300 miles away—could cost $30 billion. [redacted] 25X1

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MOPI has been willing to listen to foreigners' proposals for joint cooperation in developing the northwest, but recent policy statements from Beijing say that serious efforts are still five years away, following basin and pipeline studies. In the meantime, international seismic crews—including US and French companies—are already at work in the Tarim basin. [redacted] 25X1

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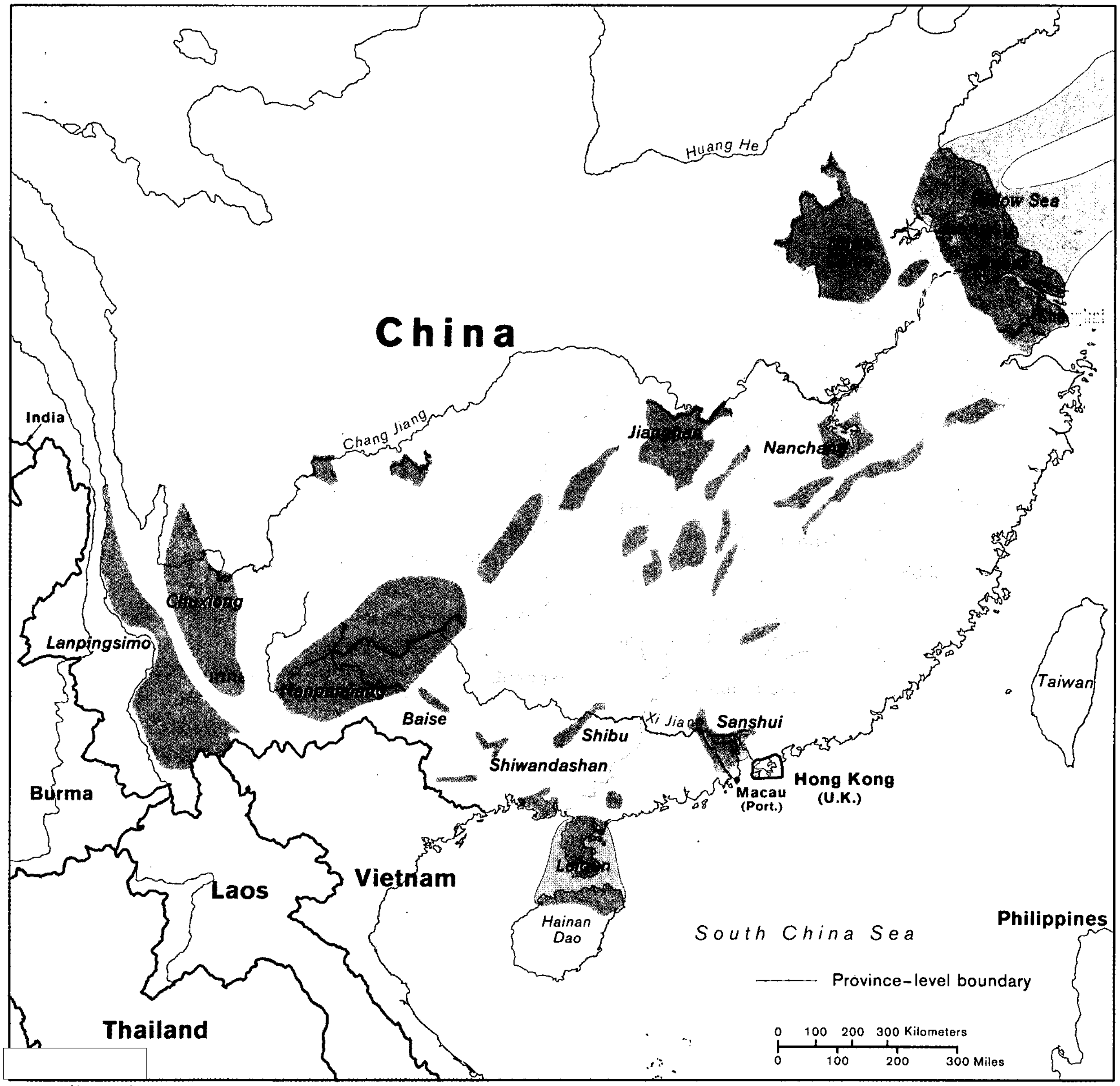
Figure 2
Onshore Oil Basins in Southern China



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And How . . .

MOPI in 1985 set up a new corporation to negotiate onshore contracts with foreigners, the China National Oil Development Corporation (CNODC). The Chinese informed the head of one of the first delegations to visit the southern basins that CNODC had decided to focus its efforts on development and production contracts, with service contracts to be arranged later by Western participants. [redacted]

One onshore cooperation contract was signed in 1985 with the Australian firm Broken Hill Petroleum to develop oil production on Hainan Island. But because Guangdong provincial authorities negotiated the contract before CNODC was formed, CNODC has told Western oil companies that the Hainan contract will not serve as the model contract for onshore cooperation. Negotiations for other onshore sites are also under way, but a model contract for onshore cooperation is still being worked out. [redacted]

CNODC says the model onshore contract will be similar to the model offshore contract, but that they hope to reduce up-front costs to attract smaller firms. MOPI may drop mandatory signature bonuses, reduce work commitments, and allow more leeway on requirements to use local labor and services. [redacted]

And With Whom

On the basis of the comments of CNODC officials, we believe China is looking for smaller independents—specifically US firms—in addition to the large multinationals already involved in offshore efforts. The Chinese hope that these smaller basins in the southern provinces will provide opportunities attractive to a wider group of oil producers and increase competitive bidding. MOPI is also trying to encourage new entrants with claims that previous offshore participation will not be a prerequisite—or earn special consideration—for any onshore deals. CNODC, meanwhile, has told visitors that participation in southern onshore basins will be a precondition to negotiations for future concessions in the northwest. CNODC says that smaller firms that participate onshore in the south can then form consortiums to compete against larger firms in the northwest. [redacted]

The Bureaucratic Obstacles

China's strategies for attracting additional foreign investment—especially onshore—complicate cooperation with Western firms. [redacted] 25X1

Poor Data. The oil potential in China's southern provinces is hard to estimate because the area has never been properly explored or surveyed. China's budgeting for surveys and exploration fell off sharply after the discovery of Daqing, and seismic teams still use unreliable 1950s-vintage technology. [redacted] The Chinese could have much more, deeper oil than they are able to find using their own antiquated survey equipment. [redacted]

Intermittent Offerings. The Chinese are not making a large number of basins available simultaneously, as they did with the first round of offshore bid blocks. CNODC plans to offer two or three areas at a time, bringing foreigners to China to visit the basins and beginning negotiations immediately afterward. The first basins made available after negotiations had begun for Hainan were the Subei Basin in Jiangsu, the Sanshui Basin in Guangdong, and the Baise (or Bose) Basin in Guangxi (see figure 2). No contracts have been signed for these areas. China has not publicly announced which basins will be in later groups, or when these offerings will be open to negotiation. [redacted]

We think MOPI's approach complicates foreign decisions about which areas to pursue. The first set of basins may be awarded before companies can evaluate later offerings. Staggering its onshore offerings could work for or against CNODC. A sizable early discovery could bolster expectations and encourage prospective investors to offer CNODC more for later blocks. Conversely, a round or two of poor showings could damage prospects for attracting bids on other basins. [redacted]

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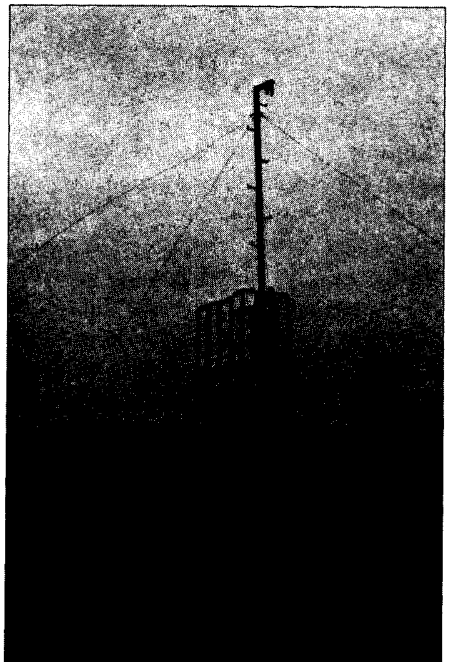

Oil well, Guangxi Province [redacted]

Efforts To Add New Players. In spite of CNODC's desire to attract smaller independents to the southern provinces, competition will be difficult for whatever independents are willing—and able—to do business with China. New firms will have to make several costly trips to China, and, [redacted] pay fees that are heavily padded by CNODC for data packages and basin tours. CNODC's claim that cooperation in the southern provinces will be a precondition for participation in the northwest also works against the smaller firms by attracting the major oil companies to this region. Smaller firms looking at minor basins may find themselves outbid by the majors who are using participation in the south as an "entry fee" to the more lucrative northwest. [redacted]

MOPI's Bureaucracy Battles. Some of the biggest obstacles to successful cooperation onshore may come from the Chinese themselves. According to US Embassy reporting, competition within the Chinese bureaucracy has surfaced in a number of areas that directly affect China's onshore development efforts. CNODC claims to have sole authority to deal with foreigners in the southern provinces, but both the Ministry of Geology and CNODC's parent corporation within MOPI—the China National Oil and Gas Exploration and Development Corporation—have apparently tried to sell data packages as well. [redacted]

Western firms trying to work onshore may find themselves caught between competing ministries or corporations. Joint ventures with CNODC may be forced to buy MOPI-produced equipment, or barred from buying higher quality equipment produced by China's Ministry of Machine Building; they may face conflicting directives or even interference from provincial authorities who had little influence on the offshore program. We expect that as cooperation progresses bureaucratic hassles will force the Chinese to draft and issue regulations more sharply defining the relationships among ministerial- and provincial-level authorities—as was done before signing offshore contracts. [redacted] 25X1 25X1 25X1

Prospects for Cooperation

We believe most Western oil companies cannot afford to take the risk of investing more in China as long as the price of oil is low. Many of the smaller independent US oil companies that Beijing particularly hoped to attract onshore probably will be wary of entering the market. Press reports indicate that these companies largely depend on small, marginally profitable fields—ironically, one of the reasons China sought to attract them. If oil prices remain at $15 per barrel or less, [redacted] many of these firms will go out of business; those that survive will be reluctant or unable to afford to mount an expensive effort to develop risky fields in China. For this reason, we think that China's onshore cooperation effort will probably feature limited participation with the larger international companies—most likely those first-round participants offshore that already have offices, contacts, and experience dealing with China, and, as a result, face lower startup costs for new cooperative efforts. [redacted]

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Benefits to China From Foreign Cooperation

China's experience to date with Western oil firms has already had a strong positive influence on its petroleum industry. Offshore cooperation in exploration and increased onshore reliance on Western technology have resulted in improvements in many areas of China's oil industry:

- ***Better reserve estimates.*** *New survey methods and data-processing techniques have led to better reserve estimates and new discoveries at existing fields. According to an industry journal, Western geologists say that reserve calculations were revised upward by 20 percent at Daqing last year after reanalyzing reservoir data with imported software. The Chinese say Shengli doubled its reserves in 1983-84, with new discoveries totaling 8 billion barrels.*

- ***Improved drilling and production.*** *Imports have tremendously improved China's stock of oilfield equipment. The Daqing oilfield has bought over $1 billion in foreign oilfield equipment since 1981, financed largely by low-cost loans from the World Bank. The Shengli field began updating its antiquated stock of 150 drilling rigs in 1984-85 with 20 US rigs. As a result, Shengli was able to accelerate drilling schedules after the new discoveries; the Chinese report that they increased oil production at Shengli by 22 percent in 1984 and 18 percent in 1985.*

- ***Better training.*** *Many contracts for equipment or technology transfer have included training programs for Chinese workers both on site and abroad. The Chinese have fully exploited these programs, occasionally to the detriment of the project incorporating the training.* 25X1

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- ***And a possible problem.*** *One concern outside the oil ministry is the effect of a sizable influx of foreigners over the next few years. In the past, the Chinese have kept most foreign oil workers offshore or restricted them to surveying remote oil basins.*

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We believe that any black-market or other dealings linked to the foreign presence would almost certainly be used by conservative opposition to attack China's reforms and open-door policies. 25X1

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Major oil companies from both the United States and abroad, however, are already finding their hands tied by falling revenues. Press articles and industry sources indicate that many US majors are cutting this year's exploration budgets by anywhere from 33 to 95 percent. As a result, we think most firms will drive very hard bargains that China will find difficult to accept—[redacted] profit shares as high as 80 percent have been proposed by oil firms negotiating in other countries. [redacted]

On the basis of China's long-term need for oil to run its economy and provide export revenues, we believe Beijing will eventually accept less favorable contract terms in order to maintain the interest of those Western firms willing to continue negotiating. In the meantime, however, we believe the Chinese will try to prolong negotiations, hoping that oil prices—and thus their bargaining position—will strengthen. [redacted]

We think the Chinese expect world oil prices to return to more favorable levels within a year or two. Resumption of international interest as late as 1988 would still allow the Chinese to begin onshore cooperation before completing their assessments of the northwest for development around 1990. In the meantime, MOPI will probably prepare contingency plans to develop the northwest on its own—which we believe the Chinese could do, but only at enormous cost and as much as a decade beyond current plans. [redacted]

The US Role in China's Oil Industry

The United States has played a major role in all phases of China's cooperation with foreigners in offshore and onshore oil. Although increasing the level of cooperation now appears unlikely, we believe US firms will continue to dominate joint operations in China's oil industry:

- *Offshore surveys.* US firms were lead operators for most of the surveys of China's offshore oil basins carried out prior to offering blocks for bid at a total cost of about $200-300 million, according to trade publications.

- *Offshore—first-round bids.* Twelve of the 19 contracts for offshore cooperation in the first round of bidding involved US companies. We estimate that total US investment obligations ran to $800 million, almost half the $1.7 billion in first-round foreign commitments.

- *Offshore—first-round discoveries.* Consortiums led by US firms found four of China's seven significant offshore discoveries to date, including the three best shows from the Pearl River Basin. 25X1 25X1

- *Offshore—second-round bids.* US firms have signed for five of the first seven bid blocks awarded in the second round, including the most promising blocks, adjacent to first-round discoveries.

- *Equipment sales.* US firms sold $248 million in oilfield equipment to China in the 1970s, and another $500 million through 1985. Equipment sold by other Western firms often incorporate US technology. 25X1

- *Onshore development of the south.* The Chinese effort to involve smaller oil companies in the southern basins is, we believe, primarily a ploy to increase competition for onshore rights, but is nonetheless targeted directly at US independents. [redacted] 25X1

We think US firms can expect China's purchases of new oilfield equipment to taper off over the next two years. Budget cuts and foreign exchange constraints will force Beijing—despite priorities—to replace recent large purchases of equipment for existing fields with acquisitions of prototypes to bolster domestic production capabilities. In the meantime, we expect the Chinese to buy more used equipment—liquidated by US independents in financial difficulties—to meet their near-term needs. [redacted] 25X1 25X1

On the other hand, US oil exploration consultants stand to gain from a reduction in Western cooperation. A China striving to conduct its own seismic exploration, mapping, and field analysis will, we believe, turn for assistance and guidance to US experts unaffiliated with oil development and marketing firms. [redacted] 25X1

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Figure 3
Bo Hai and Yellow Sea Oil Exploration

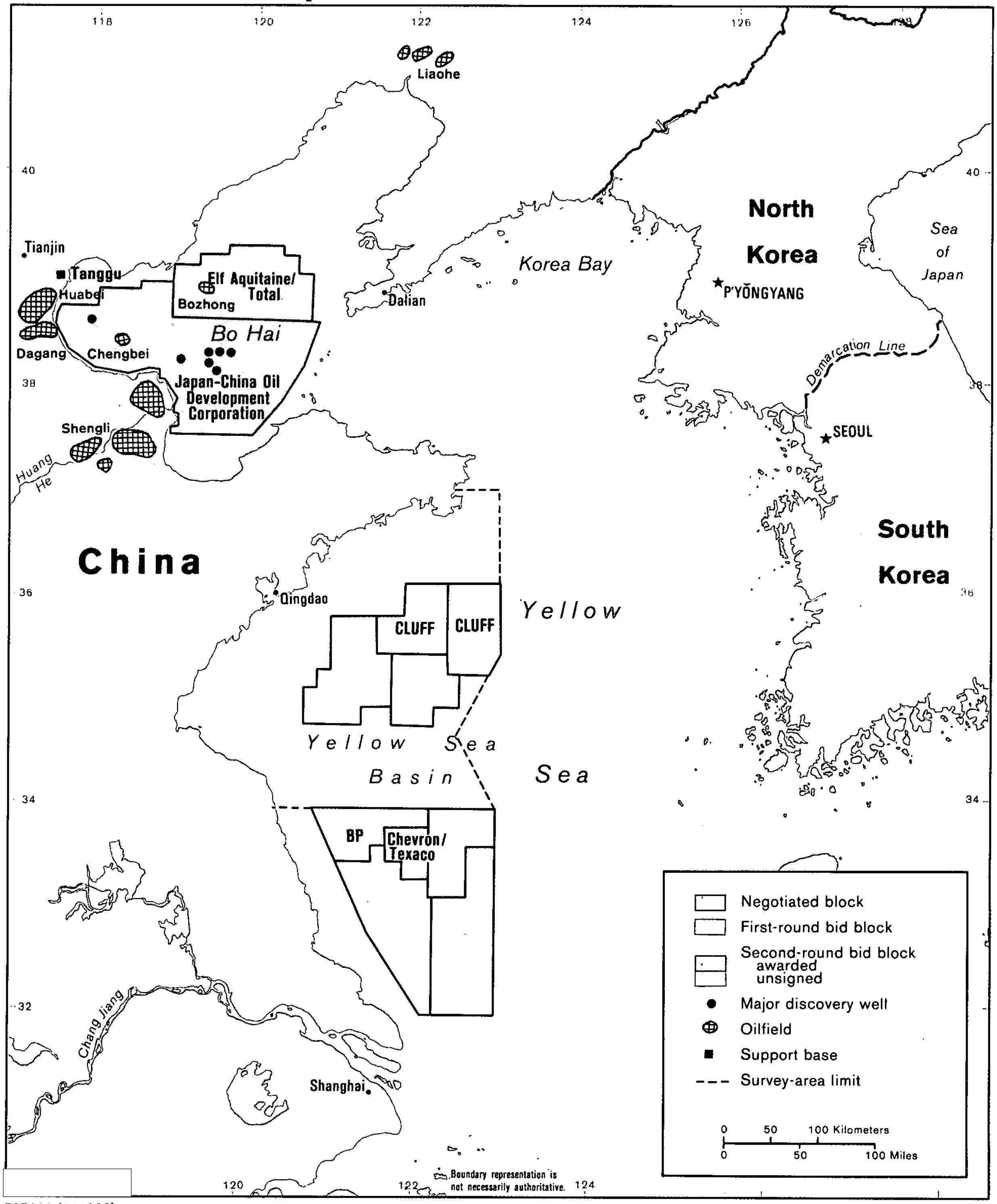

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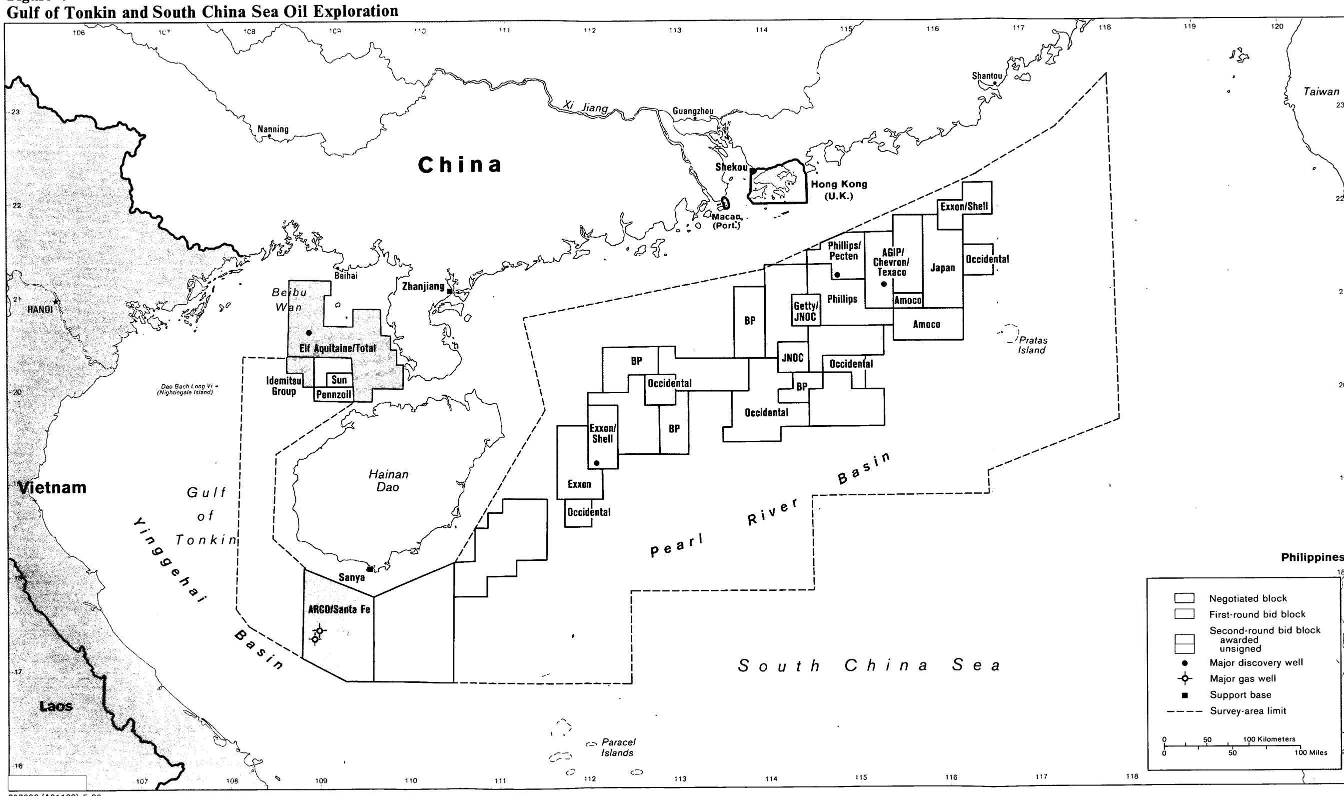
Figure 4
Gulf of Tonkin and South China Sea Oil Exploration



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